



[BILLING CODE 6760-01-P]

FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

5 CFR Parts 1600, 1601, 1604, 1605, 1650, 1651, 1653, 1655, and 1690

Roth Feature to the Thrift Savings Plan and Miscellaneous Uniformed Services Account Amendments

AGENCY: Federal Retirement Thrift Investment Board

ACTION: Proposed rule with request for comments.

SUMMARY: The Federal Retirement Thrift Investment Board (Agency) proposes to amend its regulations to add a Roth feature to the Thrift Savings Plan. The Agency also proposes to reorganize regulatory provisions pertaining to uniformed services accounts.

DATES: Comments must be received on or before **[Please insert date 60 days after date of publication in the FEDERAL REGISTER]**.

ADDRESSES: You may submit comments using one of the following methods:

- Mail: Office of General Counsel, Attn: Thomas Emswiler, Federal Retirement Thrift Investment Board, 1250 H Street, N.W., Washington, DC 20005.

- Hand Delivery/Courier: The address for sending comments by hand delivery or courier is the same as that for submitting

comments by mail.

- Facsimile: Comments may be submitted by facsimile at (202) 942-1676.

The most helpful comments explain the reason for any recommended change and include data, information, and the authority that supports the recommended change.

FOR FURTHER INFORMATION CONTACT: Laurissa Stokes at (202) 942-1645.

SUPPLEMENTARY INFORMATION: The Federal Retirement Thrift Investment Board (Agency) administers the Thrift Savings Plan (TSP), which was established by the Federal Employees' Retirement System Act of 1986 (FERSA), Public Law 99-335, 100 Stat. 514. The TSP provisions of FERSA are codified, as amended, largely at 5 U.S.C. 8351 and 8401-79. The TSP is a defined-contribution retirement savings plan for Federal civilian employees and members of the uniformed services. The TSP is similar to a private-sector "401(k) plan", i.e., a cash or deferred arrangement described in section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)).

The assets of the TSP are held in trust in the Thrift Savings Fund. Contributions to, or distributions from, the Thrift Savings Fund are treated under the Internal Revenue Code in the same manner as contributions to, or distributions from, a qualified trust described in section 401(a) of the Internal

Revenue Code. See 5 U.S.C. 8440; 26 U.S.C. 7701(j).

The Thrift Savings Plan Enhancement Act of 2009, Pub. L. 111-31, Division B, Title I, authorized the Agency to implement a qualified Roth contribution program described in section 402A of the Internal Revenue Code. This feature will allow participants to make TSP contributions on an after-tax basis and receive tax-free earnings upon distribution if (1) five years have passed since January 1 of the year in which they made their first Roth contribution, and (2) a qualifying event has occurred (*i.e.*, attainment of age 59 ½, permanent disability, or death). The TSP Roth feature is similar to a designated Roth account maintained by a 401(k) plan.

Scope

This document sets forth the rules and procedures by which the Agency proposes to administer the Roth feature. This document does not, however, address in great detail the tax treatment of a contribution to, or distribution from, a Roth TSP balance. The tax treatment of a contribution to, or distribution from, a Roth TSP balance is governed by section 402A of the Internal Revenue Code.

Types of TSP Accounts and Balances

The TSP offers the following four types of accounts: civilian accounts, uniformed services accounts, civilian beneficiary participant accounts, and uniformed services

beneficiary participant accounts. A participant's Roth contributions and associated earnings may be one balance among several balances maintained in one or more of these four types of accounts. The Agency has adopted new terminology by which to refer to each of these balances.

Within each of these four types of accounts, the Agency may maintain a "Roth balance." A Roth balance consists of (1) Roth contributions and associated earnings and (2) Roth money transferred into the TSP and associated earnings. No other contributions (e.g. matching or Agency Automatic (1%) Contributions) will be allocated to the participant's Roth balance. The Agency will separately account for all Roth balance contributions, gains, and losses in order to determine the taxable and nontaxable portions of a distribution from a participant's account.

Within each of these four types of accounts, the Agency may also maintain a "traditional balance." A traditional balance consists of (1) tax-deferred employee contributions and associated earnings; (2) tax-deferred amounts rolled over or transferred into the TSP and associated earnings; (3) tax-exempt contributions and associated earnings; (4) matching contributions and associated earnings; and (5) Agency Automatic (1%) Contributions and associated earnings.

Within a traditional balance, the Agency may maintain a

"tax-deferred balance" and a "tax-exempt balance." A tax-deferred balance consists of all amounts in a participant's traditional balance that would otherwise be includible in gross income if paid directly to the participant. A tax-exempt balance consists only of tax-exempt contributions made to a participant's traditional balance. Earnings on tax-exempt contributions will be included in the participant's tax-deferred balance. Because a tax-exempt balance includes only tax-exempt contributions, the terms "tax-exempt balance" and "tax-exempt contributions" are interchangeable.

Tax-exempt contributions are employee contributions made to a uniformed services participant's traditional balance from pay which is exempt from taxation under 26 U.S.C. 112 because it was earned in a combat zone. Consequently, only a traditional balance that is in a uniformed services account or a uniformed services beneficiary participant account may contain tax-exempt contributions.

The term "tax-exempt contributions" does not include contributions made to the participant's Roth balance from pay which is exempt from taxation under 26 U.S.C. 112. Whether a Roth contribution is made from taxable pay or tax-exempt pay, the Agency will maintain all Roth contributions in a participant's Roth balance.

Upon adoption of this proposed regulation, any reference in

the Agency's regulations to a participant's "account balance" will mean the aggregate of the participant's traditional balance and the participant's Roth balance.

Employee Contribution Elections

Section 1600.11 currently permits the following types of contribution elections: (1) to make employee contributions; (2) to change the amount of employee contributions; and (3) to terminate employee contributions. The Agency proposes to amend § 1600.11 to add an election to change the *type* of employee contributions.

The Agency also proposes to add a new section, 1600.20, to describe the types of employee contributions that a participant may make. Section 1600.20 permits employees to make traditional contributions, Roth contributions, or a combination of both. Paragraph (c) of § 1600.20 ensures that a uniformed services participant's tax-exempt pay will be contributed to his or her traditional or Roth balance (or a combination of both) in accordance with the contribution election made under § 1600.11.

Section 1690.1 contains definitions generally applicable to the TSP. The Agency proposes to add definitions for the terms "employee contributions," "traditional contributions," and "Roth contributions." Employee contributions are traditional contributions and Roth contributions made at the participant's election pursuant to § 1600.12 and deducted from compensation

paid to the participant.¹

Traditional contributions are tax-deferred employee contributions and tax-exempt employee contributions made to the participant's traditional balance. Roth contributions are employee contributions made to the participant's Roth balance. A participant's employing agency will deduct Roth contributions from taxable pay on an after-tax basis or from pay exempt from taxation under 26 U.S.C. 112.

Maximum Employee Contributions

Section 1600.22 currently provides that contributions, other than catch-up contributions, made at the participant's election are subject to the elective deferral limit contained in section 402(g) of the Internal Revenue Code. Like tax-deferred employee contributions, Roth contributions are subject to the Internal Revenue Code's elective deferral limit. See 26 U.S.C. 402A(c)(2); 26 CFR 1.402(g)-1(b)(5).

The Agency proposes to revise § 1600.22 to provide that tax-deferred contributions and Roth contributions, but not tax-exempt contributions to a participant's traditional balance, are subject to the Internal Revenue Code's elective deferral limit. Elective deferrals are, by definition, tax-deferred contributions unless they are Roth contributions. See 26 CFR

¹ The term "employee contributions" as defined in § 1690.1 is not synonymous with the term "employee contributions" as defined in 26 CFR 1.401(m)-1(a)(3).

1.402(g)-1(a). Tax-exempt contributions to a participant's traditional balance are neither tax-deferred contributions nor Roth contributions. These tax-exempt contributions are treated as basis for tax purposes and the Agency does not track them against the maximum elective deferral limit set forth in 26 U.S.C. 402(g).

A participant may make traditional contributions and Roth contributions during the same year, but the combined total of tax-deferred employee contributions and Roth contributions cannot exceed the Internal Revenue Code's elective deferral limit. Likewise, a participant may make employee contributions to both a civilian account and a uniformed services account during the same year, but the combined total of tax-deferred employee contributions and Roth contributions to both accounts cannot exceed the Internal Revenue Code's elective deferral limit.

The Agency also proposes to delete all references to the percentage limitation on contributions that existed prior to 2006. Those references are obsolete. The Consolidated Appropriations Act for Fiscal Year 2001, Public Law 106-554, changed the limits on FERS and CSRS TSP employee contributions by raising the percentage limitation by one percent each year until 2006, when the limits were removed altogether. The maximum TSP employee contribution is now limited only by the provisions

of the Internal Revenue Code.

Catch-up Contributions

The Agency proposes to move the catch-up contribution rules from paragraph (b) of § 1600.22 to a new section numbered 1600.23.

FERSA provides that an eligible participant (as defined by section 414(v) of the Internal Revenue Code) may make catch-up contributions to the Thrift Savings Fund to the extent permitted by section 414(v) and Agency regulations. 5 U.S.C. 8432(a)(3). The Internal Revenue Code permits eligible participants to make Roth catch-up contributions. The Agency therefore proposes to allow eligible participants to designate catch-up contributions as Roth catch-up contributions.

Under section 414(v) of the Internal Revenue Code, catch-up contributions must be elective deferrals. For reasons explained above, the Agency does not treat tax-exempt contributions to a traditional balance as elective deferrals. Therefore, members of the uniformed services are not permitted to make catch-up contributions to a traditional balance from tax-exempt pay. However, members of the uniformed services may make catch-up contributions to a Roth balance from tax-exempt pay. All catch-up contributions are subject to the limit described in section 414(v) of the Internal Revenue Code.

A participant may make traditional catch-up contributions

and Roth catch-up contributions during the same year, but the combined total amount of catch-up contributions of both types cannot exceed the Internal Revenue Code's catch-up contribution limit. Likewise, a participant who has both a civilian account and a uniformed services account may make catch-up contributions to both accounts during the same year, but the combined total amount of catch-up contributions to both accounts cannot exceed the Internal Revenue Code's catch-up contribution limit.

Employing Agency Contributions

The Agency proposes to add a new section, 1600.19, to address rules and procedures related to employing agency contributions. Section 1600.19 provides that a participant's eligibility to receive matching contributions is the same whether the participant chooses to make traditional contributions, Roth contributions, or a combination of both. Section 1600.19 also provides that the Agency will allocate all employing agency contributions to the tax-deferred balance within a participant's traditional balance.

For example, suppose a FERS participant elects to contribute 1% of his or her basic pay as a traditional contribution and 2% of his or her basic pay as a Roth contribution. The employing agency must contribute 3% of that employee's basic pay to the employee's tax-deferred balance as a matching contribution. Because the employee is a FERS

participant, the employing agency must also contribute Agency Automatic (1%) Contributions to the employee's tax-deferred balance whether or not he or she continues to make employee contributions.

Transfers and Rollovers Into the TSP

The Agency proposes to amend § 1690.1 to add a definition for the term "trustee-to-trustee transfer" (or "transfer"). A trustee-to-trustee transfer is a payment of an eligible rollover distribution directly from one eligible employer plan, traditional IRA, or Roth IRA to another eligible employer plan, traditional IRA, or Roth IRA at the participant's request.²

Section 1600.32 provides two methods for transferring an eligible rollover distribution into the TSP: (1) trustee-to-trustee transfer (*i.e.*, direct rollover), and (2) rollover by the participant within 60 days of receipt. The Agency proposes to revise § 1600.32 by redesignating it as § 1600.31 and by providing the conditions under which the Agency will accept a transfer consisting of Roth money.

Specifically, the Agency must receive (1) a statement from the plan administrator indicating the first year of the participant's 5 year Roth non-exclusion period (as defined by 26 U.S.C. 402A(d)(2)(B)) under the distributing plan, and (2)

² The term "trustee-to-trustee transfer," as it is used in the Agency's regulations, is synonymous with the term "direct rollover" as that term is used in 26 CFR 1.401(a)(31)-1

either the portion of the transfer amount that represents Roth contributions (i.e., tax basis) or a statement that the entire amount of the transfer is a qualified Roth distribution (as defined by 26 U.S.C. 402A(d)(2)(A)). This requirement is necessary to enable the TSP to determine whether the earnings portion of any subsequent distribution from the participant's Roth balance may be received tax-free.

The Agency also proposes to revise § 1600.32 to provide that the TSP will not accept Roth money that is rolled over by a participant after the participant has received the distribution. A rollover by the participant in lieu of a transfer would result in several disadvantages to the participant. First, when a participant does a rollover after he or she receives a distribution of Roth money in lieu of doing a transfer, the first taxable year in which the participant made a Roth contribution to the distributing plan does not carry over to the TSP for purposes of determining whether the earnings portion of a subsequent distribution from the participant's Roth balance may be received tax-free. See 26 CFR 1.402A-1, Q&A-5(c). Second, the Internal Revenue Service prohibits participants from rolling over any nontaxable portion of a distribution from a designated Roth account (i.e., a Roth 401(k), Roth 403(b), or Roth 457(b) account) after the participant has received the distribution. See 26 CFR 1.402A-1, Q&A-5(a). For these reasons, the TSP will

accept Roth money only if the TSP receives the money via trustee-to-trustee transfer (*i.e.*, direct rollover).

FERSA provides that the maximum amount permitted to be transferred to the Thrift Savings Fund shall not exceed the amount which would otherwise have been included in the participant's gross income for Federal income tax purposes. See 5 U.S.C. 8432(j)(2). In accordance with FERSA, § 1600.31 prohibits the transfer of after-tax or tax-exempt money into the TSP. The Agency proposes to redesignate § 1600.31 as § 1600.30 and revise paragraph (c)(1)(vi) of redesignated § 1600.30 to clarify that FERSA's prohibition against transferring after-tax money or tax-exempt money into the TSP does not apply to Roth money. Although FERSA's prohibition against transferring after-tax money or tax-exempt money into the TSP does not apply to Roth money, the Internal Revenue Code prohibits the transfer of Roth money from a Roth IRA to the TSP Roth balance. Therefore, the TSP will only accept Roth money if it is transferred from a designated Roth account (*i.e.*, a Roth 401(k) account, Roth 403(b) account, or Roth 457(b) account)

In summary, the Agency will not accept a rollover of Roth money distributed from any plan or IRA after the participant has received the money. The Agency cannot accept Roth money that is transferred from a Roth IRA. The Agency will, however, accept Roth money that is transferred from a designated Roth account

(i.e., a Roth 401(k) account, Roth 403(b) account, or Roth 457(b) account).

Automatic Enrollment Program

Section 1600.34 currently provides that all newly hired Federal employees eligible to participate in the TSP (and Federal employees rehired after a separation in service of 31 or more calendar days and eligible to participate in the TSP) will automatically have 3% of their basic pay contributed to the TSP. These default employee contributions will be made unless the employee elects not to contribute or to contribute at some other level before the end of the employee's first pay period. The introduction of Roth contributions makes it necessary to establish whether default employee contributions are traditional contributions or Roth contributions. Accordingly, the Agency proposes to amend § 1600.34 to provide that all default employee contributions shall be contributed to the employee's traditional balance.

Section 1600.34 also currently provides that an employee can opt out of automatic enrollment and/or terminate default employee contributions by submitting a contribution election. Under the proposed revision to § 1600.11, a contribution election includes an election to change, add, or terminate any type of contribution. For consistency, the Agency also proposes to amend § 1600.34 to provide that an employee can opt out of

automatic enrollment and/or terminate default employee contributions by submitting an election to make Roth contributions. A participant can opt out of automatic enrollment or terminate default employee contributions by submitting an election to make Roth contributions even if the election does not result in a change to the employee's total contribution percentage or amount (e.g., a participant elects to contribute 3% of his or her basic pay as Roth contributions and thus terminates all traditional contributions).

Uniformed Services Accounts

The Agency proposes to eliminate Part 1604 of the Agency's regulations. Part 1604 currently contains rules that are uniquely applicable to uniformed services accounts. However, Part 1604 also contains some redundant rules and some rules not uniquely applicable to uniformed services accounts. In addition, the Agency's regulations have evolved such that other parts also contain rules that are uniquely applicable to uniformed services accounts. For this reason, the Agency proposes to eliminate Part 1604 by deleting redundant provisions and relocating the remaining provisions as follows:

Deleted Part 1604 Provision (5 CFR)	Redundant Provision (5 CFR)
1604.5(a)(2)	1655.6(c)
1604.6(a)	1605.11
1604.7(b)	Part 1650, Subpart G

1604.9(a)	1653.2(a)(1)(iii)
1604.10(a)(2)	1655.4
1604.10(a)(3)	1655.6(c)
1604.10(b)	1655.13(a)(3)
1604.10(c)	1655.16(b)

Relocated Part 1604 Provision (5 CFR)	New Location (5 CFR)
1604.2	1690.1
1604.3	1600.12(e)
1604.4(a)(first two sentences)	1600.12(e)
1604.4(b)	1600.19(b)
1604.5(a)(first two sentences)	1600.18
1604.5(a)(1)	1600.22(c)
1604.5(b)	1600.33
1604.6(b)	1605.11(d)
1604.7(a)	1650.2(g)
1604.7(c)	1650.2(h)
1604.8	1651.14(a)
1604.9(b)	1653.5(d)
1604.9(c)	1653.5(m)
1604.9(d)	1653.5(n)
1604.10(a)(1)	1655.10(d)

Error Correction

In § 1605.1, the Agency proposes to add definitions for the terms "recharacterization" and "redesignation."

Recharacterization is the process of changing a contribution erroneously submitted by an employing agency as a tax-deferred contribution to a tax-exempt contribution or vice versa.

Redesignation is the process of changing a contribution erroneously submitted by an employing agency as a traditional contribution to a Roth contribution or vice versa. The Agency also proposes to set forth the rules and procedures for redesignation and recharacterization in a new section numbered 1605.17.

The term "recharacterization" is not synonymous with that term as it is used in regulations or guidance published by the Internal Revenue Service.³ The Agency uses "recharacterization" and "redesignation" to refer methods of error correction only. That is, a TSP contribution cannot be recharacterized or redesignated at the participant's request. Once a contribution has been made to the participant's account, it cannot be recharacterized or redesignated unless the employing agency erred in its submission. Therefore, a participant cannot elect to retroactively change the tax characteristics of contributions that have already been made. See 26 CFR 1.401(k)-1(f)(i).

The Agency also proposes to revise § 1605.12 to provide

³ Under regulations published by the Internal Revenue Service, an IRA owner may choose to "recharacterize" certain contributions (i.e., treat a contribution made to one type of IRA as made to a different type of IRA) for a taxable year. 26 CFR 1.408A-5.

that positive earnings on an erroneous contribution to a participant's Roth balance will be moved to the participant's traditional balance when the error is corrected. If the Agency were to permit earnings attributable to an erroneous contribution to remain in the Roth balance when the contribution should have been to the participant's traditional balance, the Agency would arguably permit a transfer of value from the participant's traditional balance to the participant's Roth balance. The Internal Revenue Service prohibits any transaction or accounting method involving a participant's Roth balance and any other balance that has the effect of directly or indirectly transferring value from the other balance into the Roth balance. See 26 CFR 1.402A-1, Q&A-13.

In § 1605.11, the Agency proposes to amend paragraph (c)(1) to provide that the schedule of makeup contributions elected by the participant must establish the type of contribution (*i.e.*, traditional, Roth, or both) to be made each pay period over the duration of the schedule. The Agency also proposes to add paragraph (c)(12) to provide that a participant cannot contribute a makeup contribution with an "as of" date occurring prior to [Roth implementation date] to his or her Roth balance. If the "as of" date of a late or makeup Roth contribution is earlier than the existing date of a participant's first Roth contribution, the Agency will adjust the start date of the

participant's 5 year non-exclusion period (as defined by 26 U.S.C. 402A(d)(2)(B) accordingly.

Transfers from the TSP

The Agency proposes to revise §§ 1650.2, 1650.23, 1651.14, 1653.3, and 1653.5 to add Roth IRAs to the types of retirement savings vehicles to which a participant, beneficiary, or alternate payee might choose to transfer or roll over a TSP distribution. The Agency also proposes to add a new section, 1650.25, to address rules and procedures pertaining to transfers from the TSP.

Proposed § 1650.25 permits a participant to elect to transfer an eligible rollover distribution consisting of funds from his or her traditional balance to a single eligible employer plan or IRA and funds from his or her Roth balance to another eligible employer plan or IRA. The Agency will also allow a participant to elect to transfer the traditional and Roth portions of a payment to the same plan or IRA but, for each type of balance, the election must be made separately and each type of balance will be transferred separately. The Agency will not transfer portions of a participant's traditional balance to two different eligible employer plans and/or IRAs or portions of a participant's Roth balance to two different eligible employer plans and/or IRAs.

Paragraph (c) of § 1650.25 requires the TSP to inform the

plan administrator or trustee of the plan or Roth IRA receiving a distribution from a Roth TSP balance of (1) the start date of the participant's Roth 5 year non-exclusion period or the date of the participant's first Roth contribution, and (2) the portion of the distribution that represents Roth contributions. If a participant elects not to transfer a distribution from his or her Roth balance, the Agency will inform the participant of the amount of the distribution that represents Roth contributions.

Paragraph (e) of § 1650.25 clarifies that a participant may transfer a distribution from the TSP to another eligible employer plan or to an IRA only to the extent the transfer is permitted by the Internal Revenue Code.

Pro Rata Distributions

The Agency proposes to amend its regulations to provide that all distributions (including loans, death benefit distributions, court-ordered payments, and required minimum distributions) from the TSP will be disbursed pro rata from a participant's traditional and Roth balance. To allow participants to designate the source of their distributions would require significant record keeping system modifications that would delay the availability of Roth contributions. The Agency intends to revisit this distribution policy three to five years after the Roth contribution feature becomes available.

Internal Revenue Code section 72 precludes the TSP from allocating the portion of an account balance that has already been taxed to a distribution in a manner that is other than pro rata. Moreover, the Agency is required to treat any distribution from a Roth balance as consisting proportionately of contributions and proportionately of earnings. See 26 CFR 1.402A-1, Q&A-7. The Agency therefore proposes to amend its regulations to require any distribution (including loans, death benefit distributions, court-ordered payments, and required minimum distributions) from a traditional balance to be pro rated between the tax-deferred balance and tax-exempt contributions (if any). In addition, any distribution (including loans, death benefit distributions, court-ordered payments, and required minimum distributions) from a Roth balance must be pro rated between contributions in the Roth balance and earnings in the Roth balance.

Annuities

The Internal Revenue Service prohibits any transaction involving a participant's Roth balance and any other balances that would have the effect of directly or indirectly transferring value from the other balance(s) into the Roth balance. 26 CFR 1.402A-1, Q&A-13. The Internal Revenue Service has noted that it may be difficult for a single annuity contract to have guarantees that apply to both Roth and non-Roth balances

without the potential for a prohibited transfer of value between the balances. See 72 FR 21107 (third column). Accordingly, the Agency proposes to amend § 1650.14 to prohibit the purchase of one annuity contract with both the traditional portion and the Roth portion of a withdrawal. If a participant who has a Roth balance and a traditional balance desires to purchase an annuity, he or she must purchase two separate contracts; one with the traditional balance and one with the Roth balance.

Section 1650.14 currently requires a minimum amount of \$3,500 to purchase an annuity. The Agency proposes to amend § 1650.14 to provide that the \$3,500 minimum threshold applies to each annuity purchased. If a participant who has a Roth balance elects to use 100% of a withdrawal to purchase life annuities and both the traditional balance and the Roth balance are below \$3,500, the TSP will reject the participant's withdrawal request. If only one balance is below \$3,500, then the TSP will pay that balance to the participant in a single payment and use the balance that is \$3,500 or above to purchase an annuity.

If a participant who has a Roth balance makes a mixed withdrawal election and both the traditional balance and the Roth balance are below \$3,500, the TSP will reject the withdrawal request. If only one balance is below \$3,500, then the TSP will pro rate that balance among the participant's other elected withdrawal options and will use the balance that is

\$3,500 or above to purchase an annuity.

Section 1650.14 currently allows a participant to select from several types of annuities: (1) single life, (2) joint life of the participant and spouse, and (3) joint life of the participant and a person with an insurable interest in the participant. The Agency proposes to amend § 1650.14 to provide that, if a participant is required to purchase two separate annuities, the participant's withdrawal election among the types of annuities and any available options and features, will apply to both annuities purchased. A participant cannot elect more than one type of annuity per account.

Death Benefits

The Agency proposes to amend § 1651.3 to provide that a beneficiary designation form is not valid if it attempts to designate beneficiaries for the participant's traditional balance and the participant's Roth balance separately. The Agency also proposes to amend § 1651.17 to provide that a valid disclaimer cannot specify which balance shall be disclaimed.

Court Orders

A TSP participant's account balance cannot be assigned or alienated and is not subject to execution, levy, attachment, garnishment, or other legal process except as provided for in 5 U.S.C. 8437(e)(3). Section 8437(e)(3) provides that a participant's account balance shall be subject to an obligation

of the Executive Director to make a payment to another person under a domestic relations court order described in section 8467.

A domestic relations court order is enforceable against the TSP only if it is a "qualifying retirement benefits court order" or "qualifying legal process" as defined by 5 CFR 1653. A retirement benefits court order or legal process is qualifying only if it satisfies the requirements and conditions set forth in 5 CFR 1653.2 or 5 CFR 1653.12, respectively. The Agency proposes to amend §§ 1653.2 and 1653.12 to provide that a retirement benefits court order or legal process is not qualifying if it purports to designate the TSP Fund, source of contributions, or balance (e.g. traditional, Roth, or tax-exempt) from which the payment or portions of the payment shall be made.

Loans

The Agency proposes to amend § 1655.9 to provide that the TSP will credit loan payments to a participant's traditional and Roth balances in the same proportion that the loan was distributed from the participant's account. This requirement is necessary to ensure that the loan repayment requirements under Internal Revenue Code section 72(p)(2)(C) (i.e., at least quarterly amortization of principal and interest) are satisfied separately with respect to the Roth balance.

Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities. This regulation will affect Federal employees and members of the uniformed services who participate in the Thrift Savings Plan, which is a Federal defined contribution retirement savings plan created under the Federal Employees' Retirement System Act of 1986 (FERSA), Public Law 99-335, 100 Stat. 514, and which is administered by the Agency.

Paperwork Reduction Act

I certify that these regulations do not require additional reporting under the criteria of the Paperwork Reduction Act.

Unfunded Mandates Reform Act of 1995

Pursuant to the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 602, 632, 653, 1501-1571, the effects of this regulation on state, local, and tribal governments and the private sector have been assessed. This regulation will not compel the expenditure in any one year of \$100 million or more by state, local, and tribal governments, in the aggregate, or by the private sector. Therefore, a statement under §1532 is not required.

List of Subjects

5 CFR Part 1600

Government employees, Pensions, Retirement.

5 CFR Part 1601

Government employees, Pensions, Retirement.

5 CFR Part 1604

Military personnel, Pensions, Retirement.

5 CFR Part 1605

Claims, Government employees, Pensions, Retirement.

5 CFR Part 1650

Alimony, Claims, Government employees, Pensions,
Retirement.

5 CFR Part 1651

Claims, Government employees, Pensions, Retirement.

5 CFR Part 1653

Alimony, Child support, Claims, Government employees,
Pensions, Retirement.

5 CFR Part 1655

Credit, Government employees, Pensions, Retirement.

5 CFR Part 1690

Government employees, Pensions, Retirement.

Gregory T. Long,

Executive Director,

Federal Retirement Thrift Investment Board

For the reasons stated in the preamble, the Agency proposes

to amend 5 CFR chapter VI as follows:

**PART 1600 -- EMPLOYEE CONTRIBUTION ELECTIONS, CONTRIBUTION
ALLOCATIONS, AND AUTOMATIC ENROLLMENT PROGRAM**

1. Revise the authority citation for part 1600 to read as follows:

AUTHORITY: 5 U.S.C. 8351, 8432(a), 8432(b), 8432(c), 8432(j),
8432d, 8474(b)(5) and (c)(1).

2. Amend § 1600.11 by revising paragraphs (a)(2) and (3) and
adding paragraph (a)(4) to read as follows:

§ 1600.11 Types of elections.

(a)***

(2) To change the amount of employee contributions;

(3) To change the type of employee contributions (traditional
or Roth); or

(4) To terminate employee contributions.

4. Amend § 1600.12 by adding paragraph (e) to read as follows:

§ 1600.12 Contribution elections.

(e) A uniformed service member may elect to contribute sums to
the TSP from basic pay and special or incentive pay (including
bonuses). However, in order to contribute to the TSP from

special or incentive pay (including bonuses), the uniformed service member must also elect to contribute to the TSP from basic pay. A uniformed service member may elect to contribute from special pay or incentive pay (including bonuses) in anticipation of receiving such pay (that is, he or she does not have to be receiving the special or incentive pay (including bonuses) when the contribution election is made); those elections will take effect when the uniformed service member receives the special or incentive pay (including bonuses).

§ 1600.13 [Removed]

5. In Subpart B, remove § 1600.13.

§ 1600.14 [Redesignated as § 1600.13]

6. In Subpart B, redesignate § 1600.14 as § 1600.13.

7. In Subpart C, add § 1600.18 to read as follows:

§ 1600.18 Separate service member and civilian contributions.

The TSP maintains uniformed services accounts separately from civilian accounts. Therefore, a participant who has made contributions as a uniformed service member and as a civilian employee will have two TSP accounts: a uniformed services account and a civilian account.

8. In Subpart C, add § 1600.19 to read as follows:

§ 1600.19 Employing agency contributions.

(a) *Agency Automatic (1%) Contributions.* Each pay period, any agency that employs an individual covered by FERS must make a

contribution to that employee's tax-deferred balance for the benefit of the individual equal to 1% of the basic pay paid to such employee for service performed during that pay period. The employing agency must make Agency Automatic (1%) Contributions without regard to whether the employee elects to make employee contributions.

(b) *Agency Matching Contributions.* (1) Any agency that employs an individual covered by FERS (or any service that employs an individual who has an agreement described in 37 U.S.C. 211(d)) must make a contribution to the employee's tax-deferred balance for the benefit of the employee equal to the sum of:

(i) The amount of the employee's contribution that does not exceed 3% of the employee's basic pay for such pay period; and

(ii) One-half of such portion of the amount of the employee's contributions that exceeds 3% but does not exceed 5% of the employee's basic pay for such period.

(2) A uniformed service member who receives matching contributions under 37 U.S.C. 211(d) is not entitled to matching contributions for contributions deducted from special or incentive pay (including bonuses).

(c) *Timing of employing agency contributions.* An employee appointed or reappointed to a position covered by FERS is immediately eligible to receive employing agency contributions.

9. In Subpart C, add § 1600.20 to read as follows:

§ 1600.20 Types of employee contributions.

(a) *Traditional contributions.* A participant may make traditional contributions.

(b) *Roth contributions.* A participant may make Roth contributions in addition to or in lieu of traditional contributions.

(c) *Contributions from tax-exempt pay.* A uniformed service member who receives pay which is exempt from taxation under 26 U.S.C. 112 will have contributions deducted from such pay and made to his or her traditional or Roth balance in accordance with an election made under paragraph (a) or (b) of this section.

10. Revise § 1600.21 to read as follows:

§ 1600.21 Contributions in whole percentages or whole dollar amounts.

(a) Civilian employees may elect to contribute a percentage of basic pay or a dollar amount, subject to the limits described in §1600.22. The election must be expressed in whole percentages or whole dollar amounts. A participant may contribute a percentage for one type of contribution and a dollar amount for another type of contribution. If a participant elects to contribute a dollar amount to his or her traditional balance and a dollar amount to his or her Roth balance, but the total dollar amount elected is less than the amount available to be deducted from

the participant's basic pay, the employing agency will deduct traditional contributions first and Roth contributions second.

(b) Uniformed services members may elect to contribute a percentage of basic pay and special or incentive pay (including bonus pay) subject to the limits described in §1600.22. The election must be expressed in a whole percentage for each type of contribution.

11. Revise § 1600.22 to read as follows:

§ 1600.22 Maximum employee contributions.

A participant's employee contributions are subject to the following limitations:

(a) The maximum employee contribution will be limited only by the provisions of the Internal Revenue Code (26 U.S.C.).

(b) A participant may make traditional contributions and Roth contributions during the same year, but the combined total amount of the participant's tax-deferred employee contributions and Roth contributions cannot exceed the applicable Internal Revenue Code elective deferral limit for the year.

(c) A participant who has both a civilian and a uniformed services account can make employee contributions to both accounts, but the combined total amount of the participant's tax-deferred employee contributions and Roth contributions made to both accounts cannot exceed the Internal Revenue Code elective deferral limit for the year.

12. In Subpart C, add § 1600.23 to read as follows:

§ 1600.23 Catch-up contributions.

(a) A participant may make traditional catch-up contributions or Roth catch-up contributions from basic pay at any time during the calendar year if he or she:

(1) Is at least age 50 by the end of the calendar year;

(2) Is making employee contributions at a rate that will result in the participant making the maximum employee contributions permitted under § 1600.22; and

(3) Does not exceed the annual limit on catch-up contributions contained in section 414(v) the Internal Revenue Code.

(b) An election to make catch-up contributions must be made using a Catch-Up Contribution Election form (or an electronic substitute) and will be valid only through the end of the calendar year in which the election is made. An election to make catch-up contributions will be separate from the participant's regular contribution election. The election must be expressed in whole dollar amounts.

(c) A participant may make traditional catch-up contributions and Roth catch-up contributions during the same year, but the combined total amount of catch-up contributions of both types cannot exceed the applicable Internal Revenue Code catch-up contribution limit for the year.

(d) A participant who has both a civilian account and a

uniformed services account may make catch-up contributions to both accounts, but the combined total amount of catch-up contributions to both accounts cannot exceed the Internal Revenue Code catch-up contribution limit for the year.

(e) A participant cannot make catch-up contributions to his or her traditional balance from pay which is exempt from taxation under 26 U.S.C. 112.

(f) A participant may make catch-up contributions to his or her Roth balance from pay which is exempt from taxation under 26 U.S.C. 112.

(g) A participant cannot make catch-up contributions from special or incentive pay (including bonus pay).

(h) Catch-up contributions are not eligible for matching contributions.

§ 1600.31 [Redesignated as § 1600.30]

13. In subpart D, redesignate § 1600.31 as § 1600.30 and revise paragraph (a) and add paragraphs (c) and (d) to read as follows:

§ 1600.30 Accounts eligible for transfer or rollover to the TSP.

(a) A participant who has an open TSP account and is entitled to receive (or receives) an eligible rollover distribution, within the meaning of I.R.C. section 402(c)(4) (26 U.S.C. 402(c)(4)), from an eligible employer plan or a rollover contribution, within the meaning of I.R.C. section 408(d)(3) (26

U.S.C. 408(d)(3)), from a traditional IRA may transfer or roll over that distribution into his or her existing TSP account in accordance with § 1600.31.

* * * * *

(c) Notwithstanding paragraph (b) of this section, the TSP will accept Roth funds that are transferred via trustee-to-trustee transfer from an eligible employer plan that maintains a qualified Roth contribution program described in section 402A of the Internal Revenue Code.

(d) The TSP will accept a transfer or rollover only to the extent the transfer or rollover is permitted by the Internal Revenue Code.

§ 1600.32 [Redesignated as § 1600.31]

14. In subpart D, redesignate § 1600.32 as § 1600.31 and amend it by revising paragraphs (a), (b) introductory text, and (b)(1), the second sentence in paragraph (b)(2), the first sentence in paragraph (b)(3), and paragraphs (b)(4) and (c)(1)(vi) to read as follows:

§ 1600.31 Methods for transferring or rolling over eligible rollover distributions to the TSP.

(a) *Trustee-to-trustee transfer.* (1) A participant may request that the administrator or trustee of an eligible employer plan or traditional IRA transfer any or all of his or her account directly to the TSP by executing and submitting the appropriate

TSP form to the administrator or trustee. The administrator or trustee must complete the appropriate section of the form and forward the completed form and the distribution to the TSP record keeper or the Agency must receive sufficient evidence from which to reasonably conclude that a contribution is a valid rollover contribution (as defined by 26 CFR 1.401(a)(31)-1, Q&A-14). By way of example, sufficient evidence to conclude a contribution is a valid rollover contribution includes a copy of the plan's determination letter, a letter or other statement from the plan administrator or trustee indicating that it is an eligible employer plan or traditional IRA, a check indicating that the contribution is a direct rollover, or a tax notice from the plan to the participant indicating that the participant could receive a rollover from the plan.

(2) If the distribution is from a Roth account maintained by an eligible employer plan, the plan administrator must also provide to the TSP a statement indicating the first year of the participant's Roth 5 year non-exclusion period under the distributing plan and either:

(i) The portion of the trustee-to-trustee transfer amount that represents Roth contributions (*i.e.* basis); or

(ii) A statement that the entire amount of the trustee-to-trustee transfer is a qualified Roth distribution (as defined by Internal Revenue Code section 402A(d)(2))

(b) *Rollover by participant.* A participant who has already received a distribution from an eligible employer plan or traditional IRA may roll over all or part of the distribution into the TSP. However, the TSP will not accept a rollover by the participant of Roth funds distributed from an eligible employer plan. A distribution of Roth funds from an eligible employer plan may be rolled into the TSP by trustee-to-trustee transfer only. The TSP will accept a rollover by the participant of tax-deferred amounts if the following requirements and conditions are satisfied:

(1) The participant must complete the appropriate TSP form.

(2) * * * By way of example, sufficient evidence to conclude a contribution is a valid rollover contribution includes a copy of the plan's determination letter, a letter or other statement from the plan indicating that it is an eligible employer plan or traditional IRA, a check indicating that the contribution is a direct rollover, or a tax notice from the plan to the participant indicating that the participant could receive a rollover from the plan.

(3) The participant must submit the completed TSP form, together with a certified check, cashier's check, cashier's draft, money order, treasurer's check from a credit union, or personal check, made out to the ``Thrift Savings Plan,'' for the entire amount of the rollover. * * *

(4) The transaction must be completed within 60 days of the participant's receipt of the distribution from his or her eligible employer plan or traditional IRA. The transaction is not complete until the TSP record keeper receives the appropriate TSP form, executed by the participant and administrator, trustee, or custodian, together with the guaranteed funds for the amount to be rolled over.

(c) ***

(1) ***

(vi) If not transferred or rolled over, would be includible in gross income for the tax year in which the distribution is paid. This paragraph shall not apply to Roth funds distributed from an eligible employer plan.

§ 1600.33 [Redesignated as § 1600.32]

15. In subpart D, redesignate § 1600.33 as § 1600.32.

§ 1600.32 [Amended]

16. In newly redesignated § 1600.32, in paragraphs (a) through (c), remove the phrase "§§ 1600.31 and 1600.32" and add in its place the phrase "§§ 1600.30 and 1600.31".

16. In Subpart D, add new § 1600.33 to read as follows:

§ 1600.33 Combining uniformed services accounts and civilian accounts.

Uniformed services TSP account balances and civilian TSP

account balances may be combined (thus producing one account), subject to the following rules:

(a) An account balance can be combined with another once the TSP is informed (by the participant's employing agency) that the participant has separated from Government service.

(b) Tax-exempt contributions may not be transferred from a uniformed services TSP account to a civilian TSP account.

(c) A traditional balance and a Roth balance cannot be combined.

(d) Funds transferred to the gaining account will be allocated among the TSP Funds according to the contribution allocation in effect for the account into which the funds are transferred.

(e) Funds transferred to the gaining account will be treated as employee contributions and otherwise invested as described at 5 CFR part 1600.

(f) A uniformed service member must obtain the consent of his or her spouse before combining a uniformed services TSP account balance with a civilian account that is not subject to FERS spousal rights. A request for an exception to the spousal consent requirement will be evaluated under the rules explained in 5 CFR part 1650.

(g) Before the accounts can be combined, any outstanding loans from the losing account must be closed as described in 5 CFR part 1655.

17. Revise § 1600.34 to read as follows:

§ 1600.34 Automatic enrollment program.

(a) All newly hired civilian employees who are eligible to participate in the Thrift Savings Plan and those civilian employees who are rehired after a separation in service of 31 or more calendar days and who are eligible to participate in the TSP will automatically have 3% of their basic pay contributed to the employee's traditional TSP balance (default employee contribution) unless they elect by the end of the employee's first pay period (subject to the agency's processing time frames):

- (1) To not contribute;
- (2) To contribute at some other level; or
- (3) To make Roth contributions in addition to, or in lieu of, traditional contributions.

(b) After being automatically enrolled, a participant may elect, at any time, to terminate default employee contributions, change his or her contribution percentage or amount, or make Roth contributions in addition to, or in lieu of, traditional contributions.

18. Amend § 1600.37 by revising paragraphs (a) and (b) to read as follows:

§ 1600.37 Employing agency notice.

(a) That default employee contributions equal to 3 percent of the employee's basic pay will be deducted from the employee's pay and contributed to the employee's traditional TSP balance on the employee's behalf if the employee does not make an affirmative contribution election;

(b) The employee's right to elect to not have default employee contributions made to the TSP on the employee's behalf, to elect to have a different percentage or amount of basic pay contributed to the TSP, or to make Roth contributions;

PART 1601 - PARTICIPANTS' CHOICES OF TSP FUNDS

19. Revise the authority citation for part 1601 to read as follows:

AUTHORITY: 5 U.S.C. 8351, 8432d, 8438, 8474(b)(5) and (c)(1).

20. Amend § 1601.13 by revising paragraph (a)(5) and paragraph (c) to read as follows:

§ 1601.13 Elections.

(a) ***

(5) Once a contribution allocation becomes effective, it remains in effect until it is superseded by a subsequent contribution allocation or the participant withdraws his or her entire account. If a separated participant is rehired and had not withdrawn his or her entire TSP account, the participant's last contribution allocation before separation from Government

service will be effective until a new allocation is made. If, however, the participant had withdrawn his or her entire TSP account, then the participant's contributions will be allocated to the G Fund until a new allocation is made.

(c) *Contribution elections.* A participant may designate the amount or type of employee contributions he or she wishes to make to the TSP or may stop contributions only in accordance with 5 CFR part 1600.

PART 1604 -- [REMOVED AND RESERVED]

21. Under the authority of 5 U.S.C. 8474(b)(5), remove and reserve part 1604.

PART 1605 -- CORRECTION OF ADMINISTRATIVE ERRORS

22. Revise the authority citation for part 1605 to read as follows:

AUTHORITY: 5 U.S.C. 8351, 8432a, 8432d, 8474(b)(5) and (c)(1). Subpart B also issued under section 1043(b) of Public Law 104-106, 110 Stat. 186 and §7202(m)(2) of Public Law 101-508, 104 Stat. 1388.

23. Amend § 1605.1(b) as follows:

- a. Revise the definition of *attributable pay date*.
- b. Add definitions for *recharacterization*, *recharacterization record*, *redesignation*, and *redesignation record*.

The revision and additions read as follows:

§ 1605.1 Definitions.

(b) * * *

Attributable pay date means:

(1) The pay date of a contribution that is being redesignated from traditional to Roth, or vice versa;

(2) In the case of the uniformed services, the pay date of a contribution that is being recharacterized from tax-deferred to tax-exempt, or vice versa; or

(3) The pay date of an erroneous contribution for which a negative adjustment is being made. However, if the erroneous contribution for which a negative adjustment is being made was a makeup or late contribution, the attributable pay date is the "as of" date of the erroneous makeup or late contribution.

Recharacterization means the process of changing a contribution that the employing agency erroneously submitted as a tax-deferred contribution to a tax-exempt contribution (or vice versa). Recharacterization is a method of error correction only. It applies only to the traditional balance of a uniformed services account.

Recharacterization record means a data record submitted by an employing agency to recharacterize a tax-deferred contribution that the employing agency erroneously submitted as a tax-exempt

contribution (or vice versa).

Redesignation means the process of moving a contribution (and its associated positive earnings) from a participant's traditional balance to the participant's Roth balance or vice versa in order to correct an employing agency error that caused the contribution to be submitted to the wrong balance.

Redesignation is a method of error correction only. A participant cannot request the redesignation of contributions unless the employing agency made an error in the submission of the contributions.

Redesignation record means a data record submitted by an employing agency to redesignate a contribution that the employing agency erroneously submitted to the wrong balance (traditional or Roth).

24. Amend § 1605.11 by revising paragraph (c)(1) and the second sentence in paragraph (c)(8), by adding paragraphs (c)(12) and (13), and by adding paragraph (d) to read as follows:

§ 1605.11 Makeup of missed or insufficient contributions.

(c)***

(1) The schedule of makeup contributions elected by the participant must establish the dollar amount of the contributions and the type of employee contributions

(traditional or Roth) to be made each pay period over the duration of the schedule. The contribution amount per pay period may vary during the course of the schedule, but the total amount to be contributed must be established when the schedule is created. After the schedule is created, a participant may, with the agreement of his or her agency, elect to change his or her payment amount (e.g., to accelerate payment) or elect to change the type of employee contributions (traditional or Roth). The length of the schedule may not exceed four times the number of pay periods over which the error occurred.

(8) *** If a participant separates from Government service, the participant may elect to accelerate the payment schedule by a lump sum contribution from his or her final paycheck.

(12) A participant is not eligible to contribute makeup contributions with an "as of" date occurring prior to [Roth implementation date] to his or her Roth balance.

(13) If the "as of" date of a Roth contribution that is submitted as a makeup contribution is earlier than the participant's existing Roth initiation date, the TSP will adjust the participant's Roth initiation date.

(d) *Missed bonus contributions.* This paragraph (d) applies when an employing agency fails to implement a contribution election

that was properly submitted by a uniformed service member requesting that a TSP contribution be deducted from bonus pay. Within 30 days of receiving the employing agency's acknowledgment of the error, a uniformed service member may establish a schedule of makeup contributions with his or her employing agency to replace the missed contribution through future payroll deductions. These makeup contributions can be made in addition to any TSP contributions that the uniformed service member is otherwise entitled to make.

(1) The schedule of makeup contributions may not exceed four times the number of months it would take for the uniformed service member to earn basic pay equal to the dollar amount of the missed contribution. For example, a uniformed service member who earns \$29,000 yearly in basic pay and who missed a \$2,500 bonus contribution to the TSP can establish a schedule of makeup contributions with a maximum duration of 8 months. This is because it takes the uniformed service member 2 months to earn \$2,500 in basic pay (at \$2,416.67 per month).

(2) At its discretion, an employing agency may set a ceiling on the length of a schedule of employee makeup contributions. The ceiling may not, however, be less than twice the number of months it would take for the uniformed service member to earn basic pay equal to the dollar amount of the missed contribution.

25. Amend § 1605.12 by revising paragraph (d)(1) as follows:

§ 1605.12 Removal of erroneous contributions.

(d) ***

(1) If, on the posting date, the amount calculated under paragraph (c) of this section is equal to or greater than the amount of the proposed negative adjustment, the full amount of the adjustment will be removed from the participant's account and returned to the employing agency. Earnings on the erroneous contribution will remain in the participant's account. However, positive earnings on an erroneous contribution to the participant's Roth balance will be moved to the participant's traditional balance;

26. Amend § 1605.14 by revising the first sentence in paragraph (b)(4) and the first sentence in paragraph (c)(3) to read as follows:

§ 1605.14 Misclassified retirement system coverage.

(b) ***

(4) If the retirement coverage correction is a Federal Employees' Retirement Coverage Act (FERCCA) correction, the employing agency must submit makeup employee contributions on late payment records. The participant is entitled to breakage on contributions from all sources.***

(c)***

(3) The TSP will consider a participant to be separated from Government service for all TSP purposes and the employing agency must submit an employee data record to reflect separation from Government service.***

27. Amend § 1605.15 by adding paragraph (d) to read as follows:

§ 1605.15 Reporting and processing late contributions and late loan payments.

(d) If the "as of" date of a late Roth contribution is earlier than the participant's existing Roth initiation date, the TSP will adjust the participant's Roth initiation date.

28. In Subpart B, add § 1605.17 to read as follows:

§ 1605.17 Redesignation and recharacterization.

(a) *Applicability.* This section applies to the redesignation of contributions which, due to employing agency error, were contributed to the participant's traditional balance when they should have been contributed to the participant's Roth balance or were contributed to the participant's Roth balance when they should have been contributed to the participant's traditional balance. This section also applies to the recharacterization of

contributions which, due to employing agency error, were contributed as tax-deferred contributions when they should have been contributed as tax-exempt contributions (or vice versa). It is the responsibility of the employing agency to determine whether it has made an error that entitles a participant to error correction under this section.

(b) *Method of correction.* The employing agency must promptly submit a redesignation record or a recharacterization record in accordance with this part and the procedures provided to employing agencies by the Board in bulletins or other guidance.

(c) *Processing redesignations and recharacterizations.* (1) Upon receipt of a properly submitted redesignation record, the TSP shall treat the erroneously submitted contribution (and associated positive earnings) as if the contribution had been made to the correct balance on the date that it was contributed to the wrong balance. The TSP will adjust the participant's traditional balance and the participant's Roth balance accordingly. The TSP will also adjust the participant's Roth initiation date as necessary.

(2) Upon receipt of a properly submitted recharacterization record or recharacterization request, the TSP will change the tax characterization of the erroneously characterized contribution.

(3) Agency Automatic (1%) Contributions and matching

contributions cannot be redesignated as Roth contributions or recharacterized as tax-exempt contributions.

(4) There is no breakage associated with redesignation or recharacterization actions.

PART 1650 -- METHODS OF WITHDRAWING FUNDS FROM THE THRIFT SAVINGS PLAN

29. Revise the authority citation for part 1650 to read as follows:

AUTHORITY: 5 U.S.C. 8351, 8432d, 8433, 8434, 8435, 8474(b)(5) and 8474(c)(1).

30. Amend § 1650.2 by revising the section heading and paragraphs (f) and (g) and by adding paragraph (h) to read as follows:

§ 1650.2 Eligibility and general rules for a TSP withdrawal.

(f) A participant can elect to have any portion of a single or monthly payment that is not transferred to an eligible employer plan, traditional IRA, or Roth IRA deposited directly, by electronic funds transfer (EFT), into a savings or checking account at a financial institution in the United States.

(g) If a participant has a civilian TSP account and a uniformed services TSP account, the rules in this part apply to each account separately. For example, the participant is eligible to make one age-based in-service withdrawal from each

account. A separate withdrawal request must be made for each account.

(h) All withdrawals will be distributed pro rata from the participant's traditional and Roth balances. The distribution from the traditional balance will be further pro rated between the tax-deferred balance and tax-exempt balance. The distribution from the Roth balance will be further pro rated between contributions in the Roth balance and earnings in the Roth balance. In addition, all withdrawals will be distributed pro rata from all TSP Funds in which the participant's account is invested. All pro rated amounts will be based on the balances in each TSP Fund or source of contributions on the day the withdrawal is processed.

31. Amend § 1650.11 by revising the first sentence in paragraph (c) to read as follows:

§ 1650.11 Withdrawal elections.

(c) If a participant's vested account balance is less than \$200 when he or she separates from Government service, the TSP will automatically pay the balance to the participant at his or her TSP address of record.***

32. Amend § 1650.14 by:

a. Revising paragraph (a);

b. Redesignating existing paragraphs (b) through (d) as

paragraphs (f) through (h);

c. Redesignating existing paragraphs (e) through (g) as (j) through (l); and

d. Adding new paragraphs (b), (c), (d), (e) and (i).

The revision and additions read as follows:

§ 1650.14 Annuities.

(a) A participant electing a full post-employment withdrawal can use all or a portion of his or her account balance to purchase a life annuity.

(b) If a participant has a traditional balance and a Roth balance, the TSP must purchase two separate annuity contracts for the participant: one from the portion of the withdrawal distributed from his or her traditional balance and one from the portion of the withdrawal distributed from his or her Roth balance.

(c) A participant cannot select only one balance (traditional or Roth) from which to purchase an annuity.

(d) A participant cannot elect to purchase an annuity contract with less than \$3,500.

(1) If a participant who has a traditional balance and a Roth balance elects to use 100% of his or her withdrawal to purchase a life annuity and both the traditional balance and the Roth balance are below \$3,500, the TSP will reject the participant's request. If only one balance is below \$3,500, then the TSP will

pay that balance to the participant in a single payment and use the balance that is at least \$3,500 to purchase an annuity in accordance with the participant's election.

(2) If a participant who has a Roth balance and traditional balance makes a mixed withdrawal election and both the traditional portion of the amount designated to purchase an annuity and the Roth portion of the amount designated to purchase an annuity are below \$3,500, the TSP will reject the withdrawal request. If only one portion is below \$3,500, then the TSP will pro rate that portion among the participant's other elected withdrawal options and use the portion that is at least \$3,500 to purchase an annuity in accordance with the participant's election.

(e) The TSP will purchase the annuity from the TSP's annuity vendor using the participant's entire account balance or the portion specified, unless an amount must be paid directly to the participant to satisfy any applicable minimum distribution requirement of the Internal Revenue Code. In the event that a minimum distribution is required by section 401(a)(9) of the Internal Revenue Code before the date of the first annuity payment, the TSP will compute that amount, and pay it directly to the participant.

(i) If the TSP must purchase two annuity contracts, the type

of annuity, the annuity features, and the joint annuitant (if applicable) selected by the participant will apply to both annuities purchased. A participant cannot elect more than one type of annuity by which to receive a withdrawal, or portion thereof, from any one account.

33. Revise § 1650.23 to read as follows:

§ 1650.23 Accounts of less than \$200.

Upon receiving information from the employing agency that a participant has been separated for more than 31 days and that any outstanding loans have been closed, the TSP record keeper will distribute the entire amount of his or her account balance if the account balance is \$5.00 or more but less than \$200. The TSP will not pay this amount by EFT. The participant may not elect to leave this amount in the TSP, nor will the TSP transfer this amount to an eligible employer plan, traditional IRA, or Roth IRA. However, the participant may elect to roll over this payment into an eligible employer plan, traditional IRA, or Roth IRA to the extent the roll over is permitted by the Internal Revenue Code.

34. Revise § 1650.24 to read as follows:

§ 1650.24 How to obtain a post-employment withdrawal.

To request a post-employment withdrawal, a participant must submit to the TSP record keeper a properly completed paper TSP

post-employment withdrawal request form or use the TSP Web site to initiate a request.

35. In Subpart C, add § 1650.25 to read as follows:

§ 1650.25 Transfers from the TSP.

(a) The TSP will, at the participant's election, transfer all or any portion of an eligible rollover distribution (as defined by section 402(c)(4) of the Internal Revenue Code) of \$200 or more directly to an eligible employer plan or an IRA.

(b) If a withdrawal includes a payment from a participant's traditional balance and a payment from the participant's Roth balance, the TSP will, at the participant's election, transfer all or a portion of the payment from the traditional balance to a single plan or IRA and all or a portion of the payment from the Roth balance to another plan or IRA. The TSP will also allow the traditional and Roth portions of a payment to be transferred to the same plan or IRA but, for each type of balance, the election must be made separately by the participant and each type of balance will be transferred separately. However, the TSP will not transfer portions of the participant's traditional balance to two different institutions or portions of the participant's Roth balance to two different institutions.

(c) If a withdrawal includes an amount from a participant's Roth balance and the participant elects to transfer that amount to another eligible employer plan or Roth IRA, the TSP will

inform the plan administrator or trustee of the start date of the participants Roth 5 year non-exclusion period or the participant's Roth initiation date, and the portion of the distribution that represents Roth contributions. If a withdrawal includes an amount from a participant's Roth balance and the participant does not elect to transfer the amount, the TSP will inform the participant of the portion of the distribution that represents Roth contributions.

(d) Tax-exempt contributions can be transferred only if the IRA or plan accepts such funds.

(e) The TSP will transfer distributions only to the extent that the transfer is permitted by the Internal Revenue Code.

36. Amend § 1650.31 by revising the first sentence in paragraph (a) and revising paragraph (b) to read as follows:

§ 1650.31 Age-based withdrawals.

(a) A participant who has reached age 59 1/2 and who has not separated from Government service is eligible to withdraw all or a portion of his or her vested TSP account balance in a single payment. * * *

(b) An age-based withdrawal is an eligible rollover distribution, so a participant may request that the TSP transfer all or a portion of the withdrawal to a traditional IRA, an eligible employer plan, or a Roth IRA in accordance with § 1650.25.

37. Amend § 1650.41 by revising the second sentence to read as follows:

§ 1650.41 How to obtain an age-based withdrawal.

* * * A participant's ability to complete an age-based withdrawal on the Web will depend on his or her retirement system coverage, marital status, and whether or not all or part of the withdrawal will be transferred to an eligible employer plan, traditional IRA, or Roth IRA.

PART 1651 -- DEATH BENEFITS

38. Revise the authority citation for part 1651 to read as follows:

AUTHORITY: 5 U.S.C. 8424(d), 8432d, 8432(j), 8433(e), 8435(c)(2), 8474(b)(5) and 8474(c)(1).

39. Amend §1 651.3 by adding paragraph (c)(8) to read as follows:

§ 1651.3 Designation of beneficiary.

(c)***

(8) Not attempt to designate beneficiaries for the participant's traditional balance and the participant's Roth balance separately.

40. Amend § 1651.14, by:

a. Redesignating paragraphs (d) through (i) as paragraphs (c)(1) through (c)(6), respectively; and

b. Revising paragraphs (a) through newly redesignated paragraph (c) introductory text and newly redesignated paragraph (c)(4) to read as follows:

§ 1651.14 How payment is made.

(a) Each beneficiary's death benefit will be disbursed pro rata from the participant's traditional and Roth balances. The payment from the traditional balance will be further pro rated between the tax-deferred balance and tax-exempt balance. The payment from the Roth balance will be further pro rated between contributions in the Roth balance and earnings in the Roth balance. In addition, all death benefits will be disbursed pro rata from all TSP Funds in which the deceased participant's account is invested. All pro rated amounts will be based on the balances in each TSP Fund or source of contributions on the day the disbursement is made. Disbursement will be made separately for each entitled beneficiary.

(b) *Spouse beneficiaries.* The TSP will automatically transfer a surviving spouse's death benefit to a beneficiary participant account (described in § 1651.19) established in the spouse's name. The TSP will not maintain a beneficiary participant account if the balance of the beneficiary participant account is less than \$200 on the date the account is established. The

Agency also will not transfer this amount or pay it by electronic funds transfer. Instead the spouse will receive an immediate distribution in the form of a check.

(c) *Nonspouse beneficiaries.* The TSP record keeper will send notice of pending payment to each beneficiary. Payment will be sent to the address that is provided on the participant's TSP designation of beneficiary form unless the TSP receives written notice of a more recent address. All beneficiaries must provide the TSP record keeper with a taxpayer identification number; i.e., Social Security number (SSN), employee identification number (EIN), or individual taxpayer identification number (ITIN), as appropriate. The following additional rules apply to payments to nonspouse beneficiaries:

(4) *Payment to inherited IRA on behalf of a nonspouse beneficiary.* If payment is to an inherited IRA on behalf of a nonspouse beneficiary, the check will be made payable to the account. Information pertaining to the inherited IRA must be submitted by the IRA trustee. A payment to an inherited IRA will be made only in accordance with the rules set forth in 5 CFR 1650.25.

41. Amend § 1651.17 by revising paragraphs (c) and (d) to read as follows:

§ 1651.17 Disclaimer of benefits.

(c) *Invalid disclaimer.* A disclaimer is invalid if it:

(1) Is revocable;

(2) Directs to whom the disclaimed benefit should be paid; or

(3) Specifies which balance (traditional, Roth, or tax-exempt) is to be disclaimed.

(d) *Disclaimer effect.* The disclaimed share will be paid as though the beneficiary predeceased the participant, according to the rules set forth in § 1651.10. Any part of the death benefit which is not disclaimed will be paid to the disclaimant pursuant to § 1651.14.

42. Amend § 1651.19 by adding paragraph (c)(3) and revising paragraph (m)(3) to read as follows:

§ 1651.19 Beneficiary participant accounts.

(c) ***

(3) The TSP will disburse minimum distributions pro rata from the beneficiary participant's traditional balance and the beneficiary participant's Roth balance.

(m) ***

(3) If a uniformed services beneficiary participant account contains tax-exempt contributions, any payments or withdrawals

from the account will be distributed pro rata from the tax-deferred balance and the tax-exempt balance;

PART 1653 -- COURT ORDERS AND LEGAL PROCESSES AFFECTING THRIFT SAVINGS PLAN ACCOUNTS

43. Revise the authority citation for part 1653 to read as follows:

AUTHORITY: 5 U.S.C. 8432d, 8435, 8436(b), 8437(e), 8439(a)(3), 8467, 8474(b)(5) and 8474(c)(1).

44. Amend § 1653.2 by revising paragraphs (b)(2) and (5), removing the period and adding "; and" to the end of paragraph (b)(6), and adding paragraph (b)(7) to read as follows:

§ 1653.2 Qualifying retirement benefits court orders.

(b) ***

(2) An order relating to a TSP account that contains only nonvested money, unless the money will become vested within 30 days of the date the TSP receives the order if the participant were to remain in Government service;

(5) An order that does not specify the account to which the order applies, if the participant has both a civilian TSP account and a uniformed services TSP account;

* * * * *

(7) An order that designates the TSP Fund, source of contributions, or balance (e.g. traditional, Roth, or tax-exempt) from which the payment or portions of the payment shall be made.

45. Amend § 1653.3 by revising paragraph (f)(4)(iv) to read as follows:

§ 1653.3 Processing retirement benefits court orders.

(f)***

(4)***

(iv) Information and the form needed to transfer the payment to an eligible employer plan, traditional IRA, or Roth IRA (if the payee is the current or former spouse of the participant); and

46. Amend § 1653.5 by revising paragraph (a)(1)(i), paragraph (d), and paragraph (e)(1), and by adding paragraphs (m) and (n) to read as follows:

§ 1653.5 Payment.

(a)***

(1)***

(i) The payee makes a tax withholding election, requests payment by EFT, or requests a transfer of all or a portion of the payment to a traditional IRA, Roth IRA, or eligible employer plan (the TSP decision letter will provide the forms a payee

must use to choose one of these payment options); and

(d) Payment will be made pro rata from the participant's traditional and Roth balances. The distribution from the traditional balance will be further pro rated between the tax-deferred balance and tax-exempt balance. The payment from the Roth balance will be further pro rated between contributions in the Roth balance and earnings in the Roth balance. In addition, all payments will be distributed pro rata from all TSP Funds in which the participant's account is invested. All pro rated amounts will be based on the balances in each fund or source of contributions on the day the disbursement is made. The TSP will not honor provisions of a court order that require payment to be made from a specific TSP Fund, source of contributions, or balance.

(e)***

(1) If payment is made to the current or former spouse of the participant, the distribution will be reported to the Internal Revenue Service (IRS) as income to the payee. If the court order specifies a third-party mailing address for the payment, the TSP will mail to the address specified any portion of the payment that is not transferred to a traditional IRA, Roth IRA, or eligible employer plan.

(m) A payee who is a current or former spouse of the participant may elect to transfer a court-ordered payment to a traditional IRA, eligible employer plan, or Roth IRA. Any election permitted by this paragraph (m) must be made pursuant to the rules described in 5 CFR 1650.25.

(n) If the TSP maintains an account (other than a beneficiary participant account) for a court order payee who is the current or former spouse of the participant, the payee can request that the TSP transfer the court-ordered payment to the payee's TSP account in accordance with the rules described in 5 CFR 1650.25. However, any pro rata share attributable to tax-exempt contributions cannot be transferred; instead it will be paid directly to the payee.

47. Amend § 1653.12 by revising paragraphs (c)(2) by adding paragraph (c)(6) to read as follows:

§ 1653.12 Qualifying legal processes.

(c)***

(2) A legal process relating to a TSP account that contains only nonvested money, unless the money will become vested within 30 days of the date the TSP receives the order if the participant were to remain in Government service;

(6) A legal process that designates the specific TSP Fund,

source of contributions, or balance from which the payment or portions of the payment shall be made.

PART 1655 -- LOAN PROGRAM

48. Revise the authority citation for part 1655 to read as follows:

AUTHORITY: 5 U.S.C. 8432d, 8433(g), 8439(a)(3) and 8474.

49. Amend § 1655.9 by redesignating paragraph (c) as paragraph (d) and revising it and by adding new paragraph (c) to read as follows:

§ 1655.9 Effect of loans on individual account.

(c) The loan principal will be disbursed pro rata from the participant's traditional and Roth balances. The disbursement from the traditional balance will be further pro rated between the tax-deferred balance and tax-exempt balance. The disbursement from the Roth balance will be further pro rated between contributions in the Roth balance and earnings in the Roth balance. In addition, all loan disbursements will be distributed pro rata from all TSP Funds in which the participant's account is invested. All pro rated amounts will be based on the balances in each TSP Fund or source of contributions on the day the disbursement is processed.

(d) Loan payments, including both principal and interest, will be credited to the participant's individual account. Loan

payments will be credited to the appropriate TSP Fund in accordance with the participant's most recent contribution allocation. Loan payments will be credited to the participant's traditional and Roth balances in the same proportion that the loan was distributed from the participant's account.

50. Amend § 1655.10 by adding paragraph (d) to read as follows:

§ 1655.10 Loan application process.

(d) If the TSP maintains a uniformed services account and a civilian account for an individual, a separate loan application must be made for each account.

51. Amend § 1655.15 by revising paragraph (b) to read as follows:

§ 1655.15 Taxable distributions.

(b) If a taxable distribution occurs in accordance with paragraph (a) of this section, the Board will notify the participant of the amount and date of the distribution. The Board will report the distribution to the Internal Revenue Service as income for the year in which it occurs.

PART 1690 - THRIFT SAVINGS PLAN

52. The authority citation for part 1690 continues to read as follows:

AUTHORITY: 5 U.S.C. 8474.

53. Amend § 1690.1 as follows:

a. Remove the definitions of *regular contributions* and *combat zone compensation*.

b. Revise the definitions of *account or individual account*, *catch-up contributions*, *contribution election*, *employing agency*, *separation from Government service*, *source of contributions*, *tax-deferred balance*, and *tax-exempt balance*.

c. Add definitions for *bonus contributions*, *civilian account*, *civilian employee*, *employee contributions*, *Federal civilian retirement system*, *Ready Reserve*, *Roth 5 year non-exclusion period*, *Roth balance*, *Roth contributions*, *Roth initiation date*, *Roth IRA*, *uniformed service member*, *special or incentive pay*, *tax-deferred contributions*, *tax-exempt contributions*, *traditional balance*, *traditional contributions*, *traditional IRA*, *trustee-to-trustee transfer*, and *uniformed services account*.

§ 1690.1 Definitions.

As used in this chapter:

Account or individual account means the account established for a participant in the Thrift Savings Plan under 5 U.S.C. 8439(a). The TSP offers four types of accounts: civilian participant accounts, uniformed services accounts, civilian beneficiary participant accounts, and uniformed services beneficiary participant accounts. Each type of account may

contain a traditional balance, a Roth balance, or both.

Bonus contributions means contributions made by a participant from a bonus as defined in 37 U.S.C. chapter 5.

Catch-up contributions means TSP contributions from basic pay that are made by participants age 50 and over, which exceed the elective deferral limit of 26 U.S.C. 402(g) and meet the requirements of 5 CFR 1600.23.

Civilian account means a TSP account to which contributions have been made by or on behalf of a civilian employee.

Civilian employee means a TSP participant covered by the Federal Employees' Retirement System, the Civil Service Retirement System, or equivalent retirement plan.

Contribution election means a request by an employee to start contributing to the TSP, to change the amount or type of contributions (traditional or Roth) made to the TSP each pay period, or to terminate contributions to the TSP.

Employee contributions means traditional contributions and Roth contributions. Employee contributions are made at the participant's election pursuant to § 1600.12 and are deducted

from compensation paid to the employee.

Employing agency means the organization (or the payroll office that services the organization) that employs an individual eligible to contribute to the TSP and that has authority to make personnel compensation decisions for the individual. It includes the uniformed services and their servicing payroll office(s).

Federal civilian retirement system means the Civil Service Retirement System established by 5 U.S.C. chapter 83, subchapter III, the Federal Employees' Retirement System established by 5 U.S.C. chapter 84, or any equivalent Federal civilian retirement system.

Ready Reserve means those members of the uniformed services described at 10 U.S.C. 10142.

Roth 5 year non-exclusion period means the period of five consecutive calendar years beginning on the first day of the calendar year in which the participant's Roth initiation date occurs. It is the period described in section 402A(d)(2)(B) of the Internal Revenue Code.

Roth balance means the sum of:

(1) Roth contributions and associated earnings; and

(2) Amounts transferred to the TSP from a Roth account maintained by an eligible employer plans and earnings on those amounts.

Roth contributions means employee contributions made to the participant's Roth balance which are authorized by 5 U.S.C.

8432d. Roth contributions may be deducted from taxable pay on an after-tax basis or from pay exempt from taxation under 26 U.S.C. 112.

Roth initiation date means

(1) The earlier of:

(i) The actual date of a participant's first Roth contribution to the TSP;

(ii) The "as of" date or attributable pay date (as defined in § 1605.1 of this subchapter) that established the date of the participant's first Roth contribution to the TSP; or

(iii) The date used, by a plan from which the participant directly transferred Roth money into the TSP, to measure the participant's Roth five year non-exclusion period.

(2) If a participant has a civilian account and a uniformed services account, the Roth initiation date for both accounts will be the same.

Roth IRA means an individual retirement plan described in Internal Revenue Code section 408A (26 U.S.C. 408A).

Separation from Government service means generally the cessation of employment with the Federal Government. For civilian employees it means termination of employment with the U.S. Postal Service or with any other employer from a position that is deemed to be Government employment for purposes of participating in the TSP for 31 or more full calendar days. For uniformed services members, it means the discharge from active duty or the Ready Reserve or the transfer to inactive status or to a retired list pursuant to any provision of title 10 of the United States Code. The discharge or transfer may not be followed, before the end of the 31-day period beginning on the day following the effective date of the discharge, by resumption of active duty, an appointment to a civilian position covered by the Federal Employees' Retirement System, the Civil Service Retirement System, or an equivalent retirement system, or continued service in or affiliation with the Ready Reserve. Reserve component members serving on full-time active duty who terminate their active duty status and subsequently participate in the drilling reserve are said to continue in the Ready Reserve. Active component members who are released from active duty and subsequently participate in the drilling reserve are said to affiliate with the Ready Reserve.

Source of contributions means traditional contributions, Roth

contributions, Agency Automatic (1%) Contributions, or matching contributions. All amounts in a participant's account are attributed to one of these four sources. Catch-up contributions, transfers, rollovers, and loan payments are included in the traditional contribution source or the Roth contribution source.

Special or incentive pay means pay payable as special or incentive pay under 37 U.S.C. chapter 5.

Tax-deferred balance means the sum of:

(1) All contributions, rollovers, and transfers in a participant's traditional balance that would otherwise be includible in gross income if paid directly to the participant and earnings on those amounts; and

(ii) Earnings on any tax-exempt contributions in the traditional balance. The tax-deferred balance does not include tax-exempt contributions.

Tax-deferred contributions means employee contributions made to a participant's traditional balance that would otherwise be includible in gross income if paid directly to the participant.

Tax-exempt balance means the sum of tax-exempt contributions within a participant's traditional balance. It does not include earnings on such contributions. Only a traditional balance in a uniformed services participant account or a uniformed services beneficiary participant account may contain a tax-exempt

balance.

Tax-exempt contributions means employee contributions made to the participant's traditional balance from pay which is exempt from taxation by 26 U.S.C. 112. The Federal income tax exclusion at 26 U.S.C. 112 is applicable to compensation for active service during a month in which a uniformed service member serves in a combat zone. The term "tax-exempt contributions" does not include contributions made to the participant's Roth balance from pay which is exempt from taxation by 26 U.S.C. 112.

Traditional balance means the sum of:

- (1) Tax-deferred contributions and associated earnings;
- (2) Tax-deferred amounts rolled over or transferred into the TSP and associated earnings;
- (3) Tax-exempt contributions and associated earnings;
- (4) Matching contributions and associated earnings;
- (5) Agency Automatic (1%) Contributions and associated earnings.

Traditional contributions means tax-deferred employee contributions and tax-exempt employee contributions made to the participant's traditional balance.

Traditional IRA means an individual retirement account described in I.R.C. section 408(a) (26 U.S.C. 408(a)) and an individual retirement annuity described in I.R.C. section 408(b)

(26 U.S.C. 408(b)) (other than an endowment contract).

Trustee-to-trustee transfer or transfer means the payment of an eligible rollover distribution (as defined in section 402(c)(4) of the Internal Revenue Code) from an eligible employer plan or IRA directly to another eligible employer plan or IRA at the participant's request.

Uniformed services account means a TSP account to which contributions have been made by or on behalf of a member of the uniformed services.

Uniformed service member means a member of the uniformed services on active duty or a member of the Ready Reserve in any pay status.

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